

SENSITIVE

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FEDERAL ELECTION COMMISSION  
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FIRST GENERAL COUNSEL'S REPORT

EXECUTIVE SESSION

MUR: 5976

SUBMITTED LATE

DATE COMPLAINT FILED: 02/25/2008

DATE OF NOTIFICATION: 02/28/2008

LAST RESPONSE RECEIVED: 03/31/2008

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DATE ACTIVATED: 09/10/2008

EXPIRATION OF SOL: 02/06/2013

MUR: 5984

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MUR: 6003

DATE COMPLAINT FILED: 04/28/2008

DATE OF NOTIFICATION: 05/05/2008

LAST RESPONSE RECEIVED: 05/27/2008

DATE ACTIVATED: 09/10/2008

EXPIRATION OF SOL: 02/06/2013

COMPLAINANTS:

Democratic National Committee (MUR 5976)

Jane Hamsher (MUR 5984)

Isabel Perkins *et al.* (MUR 6003)

RESPONDENTS:

John McCain 2008, Inc. and Joseph Schmuckler, in  
his official capacity as treasurer  
John McCain

RELEVANT STATUTES:

2 U.S.C. § 434(b)

2 U.S.C. § 437c(c)

2 U.S.C. § 437f(b)

2 U.S.C. § 441a(b)(1)(A)

26 U.S.C. § 9031 et seq.

26 U.S.C. § 9035

26 U.S.C. § 9038

11 C.F.R. § 100.82(e)

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11 C.F.R. § 104.3(d)(1)

11 C.F.R. § 108.7(c)(1)

11 C.F.R. § 9035.1

11 C.F.R. § 9037.1

INTERNAL REPORTS CHECKED: Disclosure Reports

FEDERAL AGENCIES CHECKED: None

**I. INTRODUCTION**

On February 25, 2008, the Democratic National Committee (the "DNC") filed a complaint alleging that John McCain 2008, Inc., and Joseph Schmuckler, in his official capacity as treasurer, (the "Committee") and Senator John McCain (collectively the "Respondents") violated, or were about to violate, the Presidential Primary Matching Payment Account Act (the "Matching Payment Program"), 26 U.S.C. § 9031 et seq. According to the complaint, the Respondents violated, or would violate, 26 U.S.C. § 9035 and 2 U.S.C. § 441a(b)(A)(1) by exceeding the expenditure limitations imposed on candidates participating in the Matching Payment Program.<sup>1</sup> The complaint notes that Senator McCain submitted a letter to the Commission on February 6, 2008 stating his intention to withdraw from the Matching Payment Program, but claims that he could not withdraw from the Matching Payment Program because the Committee entered into a commercial loan agreement in which it pledged a security interest in Matching Payment Program funds. Thus, the complaint alleges that the Respondents are

<sup>1</sup> After the receipt of the complaint in MUR 5976, two additional complaints were filed containing substantially similar allegations and facts as the complaint in MUR 5976. See Complainant of Jane Hamsher (MUR 5984); Complaint of Isabel Perkins et al. (MUR 6003). The only difference between the allegations in MUR 5976 and those in MURs 5984 and 6003 is that the latter rely on reports filed by the Committee to assert that Senator McCain had, in fact, exceeded the expenditure limitations of 26 U.S.C. § 9035 and 2 U.S.C. § 441a(b)(1)(A) as of February 29, 2008, whereas the allegation in the former complaint only stated that Senator McCain was likely to exceed those limits. Counsel for the Respondents has indicated that the response to MUR 5976 covers the allegations in both MUR 5984 and MUR 6003. Unless otherwise noted, references to the complaint or response in this Report are to the filings in MUR 5976.

1 bound by the expenditure limitations of the Matching Payment Program. The complaint also  
2 encourages the Commission to investigate whether the Committee violated the Act's reporting  
3 requirements by failing to report on Schedule C-1 that the collateral for the loan includes  
4 "certification for federal matching funds" or "public financing." See Complaint at 6. Finally, the  
5 complaint alleges that the Respondents "obtained a material, financial benefit from the  
6 certification of eligibility of matching funds through the ability to avail itself of the automatic  
7 right of access to the ballot, in some states." Complaint at 6. This issue, however, involves the  
8 manner of qualifying as a candidate for state ballots, a matter which is outside of the purview of  
9 the Commission. See 11 C.F.R. § 108.7(c)(1).

10 The response to the complaint asserts that Senator McCain was not bound by the  
11 spending limitations of the Matching Payment Program or the Federal Election Campaign Act, as  
12 amended (the "Act"), because Senator McCain had effectively withdrawn from the Matching  
13 Payment Program in a letter sent to the Commission on February 6, 2008. The Respondents  
14 further assert that Senator McCain could withdraw from the Matching Payment Program because  
15 he did not receive funds from the Department of Treasury, and that the commercial loan  
16 agreements that the Committee entered into did not pledge any public funds as security for that  
17 loan.

18 On August 21, 2008, the Commission voted to permit Senator McCain to withdraw from  
19 the Matching Payment Program and sent letters to Respondents' counsel and the Secretary of the  
20 Treasury informing them that the Commission had withdrawn its certification of eligibility for  
21 the Respondents to receive funds from the Matching Payment Account. See LRA 731 (John  
22 McCain 2008, Inc.). In light of the Commission's decision, and consistent with prior

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Commission matters where a candidate has been permitted to withdraw from the Matching Payment Program, we recommend that the Commission find no reason to believe that the Respondents violated 2 U.S.C. § 441a(b)(1)(A) or 26 U.S.C. § 9035 by exceeding the expenditure limitations imposed on candidates receiving federal matching funds. We further recommend that the Commission find no reason to believe that the Committee violated 2 U.S.C. § 434(b) and 11 C.F.R. § 104.3(d)(1) by failing to properly report collateral for Senator McCain's loan on Schedule C-P-1.

## **II. FACTUAL AND LEGAL ANALYSIS**

### **A. BACKGROUND**

#### **1. McCain's Application to Participate in the Matching Payment Program**

On August 13, 2007, Senator McCain applied to participate in the Matching Payment Program. *See* Complaint, Exhibit 1. The Commission determined on August 28, 2007 that he was eligible to receive public funds for his campaign for the Republican Party nomination for President of the United States. The Commission also certified that he was entitled to \$100,000 in Matching Payment Program funds. On December 19, 2007, the Commission certified an additional \$5,812,197.35 in Matching Payment Program funds to Senator McCain.

On November 14, 2007, the Committee entered into a business loan agreement, commercial security agreement, and promissory note with Fidelity and Trust Bank of Bethesda, Maryland for a \$3,000,000 line of credit (the "Loan Agreement"). *See* Complaint, Exhibits 4 and 5. In the original November 14, 2007, Loan Agreement, the parties described the collateral in the security agreement:

Grantor and Lender agree that any certifications of matching fund eligibility, including related rights, currently possessed by Grantor

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1 or obtained before January 1, 2008, are not themselves being  
2 pledged as security for the indebtedness and are not themselves  
3 collateral for the indebtedness or subject to this Security  
4 Agreement.

5 By its terms, this provision apparently meant that the August 2007 certification of eligibility and  
6 any rights thereunder, including any certifications of entitlement to specific amounts that derived  
7 from that certification, would be excluded from the security agreement's definition of collateral,  
8 no matter when the certification of entitlement was made or the matching funds were paid. The  
9 original loan agreement also included an "in-out-in" provision stating that, if Senator McCain

10 [W]ithdraws from the public matching fund program by the end of  
11 December 2007, but . . . then does not win the New Hampshire  
12 primary or place at least within 10 percentage points of the winner  
13 of the New Hampshire Primary, Borrower would cause [Senator]  
14 McCain to remain an active political candidate and . . . will, within  
15 thirty (30) days of the New Hampshire Primary (i) reapply for  
16 public matching funds, [and] (ii) grant to Lender, as additional  
17 collateral for the Loan, a first priority perfected security interest in  
18 and to all of Borrower's right, title and interest in and to the public  
19 matching fund program . . .

20 See Complaint, Exhibit 4.

21 On December 17, 2007, the parties executed a loan modification agreement providing for  
22 an additional \$1,000,000 line of credit (the "Modification"). See Complaint, Exhibit 6. In this  
23 agreement, the parties modified the collateral provision of the original security agreement to read,  
24 "Grantor and Lender agree that any certifications of matching funds eligibility, including related  
25 rights, *now held* by grantor are not themselves being pledged as security for the Indebtedness and  
26 are not themselves collateral for the Indebtedness or subject to this Security Agreement." *Id.*  
27 (emphasis added). In addition, the December 17 agreement modified the "in-out-on" provision,  
28 changing the trigger for re-entering the Matching Payment Program to a poor performance in the

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1 first primary or caucus after McCain withdrew from the program, instead of the New Hampshire  
2 primary.

3 2. Senator McCain's Request to Withdraw

4 Ordinarily, the United States Treasury would have paid Matching Payment Program  
5 funds to eligible candidates on the first business day of the election year. *See* 11 C.F.R. § 9037.1.  
6 The Treasury, however, was unable to do so because there was such a shortage in the Matching  
7 Payment Program account. As a result, no candidates received matching funds until  
8 mid-February 2008.

9 The Treasury had made no matching funds payments as of February 8, 2008, when  
10 Senator McCain and his Committee submitted a letter to the Commission purporting to withdraw  
11 from the Matching Payment Program. *See* Complaint, Exhibit 7. This letter stated that "no  
12 funds have been pledged as security for private financing," and indicated that Senator McCain  
13 and his Committee would "make no further requests for matching-fund payment certifications  
14 and will not accept any matching-fund payments, including the initial amount and other amounts  
15 certified by the Commission in connection with . . . [the] previous submissions." Complaint,  
16 Exhibit 7. The withdrawal letter added that the Committee had "not submitted to the Department  
17 of Treasury any bank account information" and that the Committee also would "inform  
18 [Treasury] directly of [its] withdrawal from the matching funds system."<sup>2</sup> *Id.*

19 Former Chairman Mason, on behalf of the Commission, responded in a letter dated  
20 February 19, 2008, advising Senator McCain that his letter would be treated as a request that the  
21 Commission withdraw its previous certifications. *See* Response, Exhibit 5. The letter stated that

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<sup>2</sup> The Department of the Treasury made no attempt to pay Senator McCain from the Matching Payment Account.

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1 2 U.S.C. § 437c(c) requires four affirmative votes to approve a withdrawal and informed Senator  
2 McCain that the Commission would consider the request when it had a quorum. The letter also  
3 invited Senator McCain to expand on the rationale for his assertion that neither he nor his  
4 Committee pledged the certification of Matching Payment Program funds as security for private  
5 financing, including, but not limited to, addressing specific provisions of the loan agreement.

6 On February 25, 2008, the Committee supplemented its original withdrawal letter with a  
7 letter further explaining its eligibility to withdraw from the Matching Payment Program. *See*  
8 Response, Exhibit 10. In the supplemental letter, the Committee claimed that Senator McCain's  
9 withdrawal from the Matching Payment Program "occurred automatically upon his February 6th  
10 notification" to the Commission. *See id.* The supplemental letter also included a letter from  
11 counsel on behalf of Fidelity and Trust Bank, stating that the bank did not "receive from the  
12 Committee, a security interest in any certification for matching funds" consistent with "basic  
13 principles of banking, security and uniform commercial code law." *Id.*

14 3. The Commission's Decision to Permit Senator McCain to Withdraw

15 Soon after the Commission regained a quorum on June 24, 2008, we circulated a  
16 memorandum recommending that the Commission withdraw the certification to the Secretary of  
17 the Treasury that Respondents were entitled to payment from the Matching Payment Act account.  
18 *See* LRA 731 (John McCain 2008, Inc.), Presidential Primary Matching Payment Program,  
19 Memorandum dated July 16, 2008 (circulated Aug. 13, 2008). While the memo offered two  
20 alternative rationales supporting withdrawal – namely, that withdrawal is permissible until a  
21 candidate actually receives payments under the Matching Payment Act, or until a candidate  
22 constructively receives the financial benefit of matching funds – it recommended that the

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Commission conclude Senator McCain was eligible to withdraw from the program because he did not unambiguously pledge public funds as security for private financing. *See id.* at 12-17. Specifically, the memo concluded that neither the original loan agreement nor the "in-out-in" provision unquestionably pledged funds or provided for any funds to be made available to Fidelity and Trust Bank, and thus Senator McCain never reached the "point of no return" for withdrawal from the Matching Payment Program. *See id.* at 17.

At the Open Meeting on August 21, 2008, the Commission unanimously voted to grant Senator John McCain's request to withdraw from the Matching Payment Program. During the meeting individual Commissioners expressed different views regarding *why* Senator McCain's withdrawal should be permitted, and the Commission did not vote on whether it agreed with the General Counsel's reasoning in recommending that it grant Senator McCain's request for withdrawal. Rather, without approving a specific rationale, the Commission voted to release Senator McCain from his obligations under the Matching Payment Program, withdraw the certification to the Secretary of the Treasury that the Respondents are entitled to payment from the Matching Payment Account, and approve letters to both the Respondents and the Secretary of the Treasury. *See* LRA 731 (John McCain 2008, Inc.), Certification dated Aug. 21, 2008.

In the letter to Respondent's counsel, the Commission stated,

Senator McCain and his Committee are not bound by the provisions of the candidate agreement he executed pursuant to the Act, and are not subject to the mandatory audit under the Act. 26 U.S.C. § 9038. Further, they are not bound by the spending limitations associated with the Program. 11 C.F.R. § 9035.1(d).

Letter from the Commission to Trevor Potter (Aug. 21, 2008). The Commission sent a similar letter to the Treasury, explaining that it had withdrawn its certification for Senator McCain and



1 instructing that no payments were to be made to the candidate or his committee. Letter from the  
2 Commission to Judith R. Tillman, Commissioner of the Financial Management Service, U.S.  
3 Treasury Dept. (Aug. 21, 2008).

4 **B. LEGAL ANALYSIS**

5 We recommend that the Commission find no reason to believe that the Respondents  
6 violated 2 U.S.C. § 441a(b)(1)(A) or 26 U.S.C. § 9035 because a candidate who successfully  
7 withdraws from the Matching Payment Program is considered to have been released from his or  
8 her obligations under the Matching Payment Program. See LRA 561 (Elizabeth Dolc for  
9 President) (candidate withdrawing from Program not subject to audit pursuant to 26 U.S.C.  
10 § 9038); LRA 622 (Howard Dean/Dean for America) (candidate withdrawing from Program no  
11 longer bound by terms of the candidate agreement); *see also* AO 2003-35 (Gephardt for  
12 President) (same). Where the Commission has permitted a candidate to withdraw, it has treated  
13 the withdrawal as having the same effect as a rescission of a contract, relieving the candidate and  
14 the Commission from any obligations arising from the candidate's application to participate in  
15 the Matching Payment Program. By permitting Senator McCain to withdraw from the Matching  
16 Payment Program, the Commission has relieved him of the corresponding obligations under the  
17 Program and, most importantly in this matter, the expenditure limitations of 2 U.S.C.  
18 § 441a(b)(1)(A) and 26 U.S.C. § 9035.

19 **1. Senator McCain's Withdrawal from the Matching Payment Program**

20 As discussed above, the Commission did not adopt a specific rationale in deciding to  
21 grant Senator McCain's request to withdraw from the Matching Payment Program. Based on the  
22 discussion at the Open Meeting, however, two main principles appear to have formed the basis

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1 for the Commission's decision to permit Senator McCain to withdraw. First, Senator McCain  
2 did not actually receive public funds from the Matching Payment Account and thus was eligible  
3 to withdraw from the program. See 26 U.S.C. § 9038; 11 C.F.R. § 9035.1(d). Alternatively,  
4 even if a candidate's constructive receipt of matching funds is sufficient to preclude withdrawal  
5 from the program, Senator McCain did not pledge public funds as security for private financing.  
6 See AO 2003-35 (Gephardt for President).

7 (a) Respondents Did Not Actually Receive Funds from the Matching  
8 Payment Account

9 In AO 2003-35 (Gephardt for President), the Commission considered whether  
10 Congressman Gephardt, a Democratic Presidential primary candidate in 2004, could withdraw  
11 from the Matching Payment Program. In the opinion, the Commission explained that a candidate  
12 enters into a binding contract with the Commission when he or she executes the Candidate  
13 Agreements and Certifications, but stated that it would withdraw a candidate's certification upon  
14 written request, thus agreeing to rescind the contract, if the candidate had not received Matching  
15 Payment Program funds or pledged the certification of public funds "as security for private  
16 financing." AO 2003-35 at 4. The Commission did not, however, define what this language  
17 meant. Moreover, the Gephardt Committee specifically noted in its advisory opinion request that  
18 its previous certification for an initial payment of \$100,000 would "not be pledged as security for  
19 any loan during the Committee's reconsideration of its participation in the Matching Payment  
20 Act's public funding program." Given that the Gephardt Committee's request presented facts  
21 materially distinguishable from those of a candidate who had pledged public funds as security for  
22 private financing, and the Commission could not properly establish a binding rule of law in an  
23 advisory opinion, see 2 U.S.C. § 4371(b), the Commission's reference to pledging of funds as

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1 security could not have established a binding condition precedent for withdrawal from the public  
2 funding program.

3       Aside from the language in the Gephardt opinion, nothing in Matching Payment Act  
4 jurisprudence explicitly states a candidate reaches the "point of no return" and may not withdraw  
5 from the matching funds program if he or she takes advantage of the ancillary benefits of a  
6 certification of funds without having actually received a payment of funds. To the contrary, the  
7 express language of certain parts of the Matching Payment Act, as well as the Commission's  
8 implementing regulations, contemplates that withdrawal will be permitted unless a candidate  
9 actually receives public funds. *See* 26 U.S.C. § 9038; 11 C.F.R. § 9035.1(d). Specifically,  
10 permitting the candidate to withdraw from the public funding program at any point until the date  
11 he or she actually receives payments is consistent with the language of 26 U.S.C. § 9038(a),  
12 which provides that the Commission shall audit candidates and their committees that have  
13 "received payments under [26 U.S.C. §] 9037," and 11 C.F.R. § 9035.1(d), which provides that  
14 the expenditure limits "shall not apply to a candidate who does not receive matching funds."  
15 Furthermore, permitting a candidate to withdraw from the Program who has not actually received  
16 public funds does not conflict with past Commission decisions allowing a candidate to withdraw  
17 from the Program and to avoid a Commission audit pursuant to 26 U.S.C. § 9038. *See* LRA 561  
18 (Elizabeth Dole for President) (accepting General Counsel's recommendation to permit  
19 withdrawal that relied on plain language of 26 U.S.C. § 9038). Thus, permitting a candidate to  
20 withdraw until he or she actually receives funds is a reasonable interpretation of the statutory and  
21 regulatory language of the Matching Payment Program.

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Moreover, this interpretation may be most consistent with the First Amendment principles underlying the public funding program. In *Buckley v. Valeo*, 424 U.S. 1, 57 n.65 (1976), the Supreme Court upheld the public funding program based on the premise that candidates voluntarily agree to subject themselves to specified expenditure limitations in exchange for a public benefit. Because the actual payment and receipt of funds, rather than the certification of funds, is the specific public benefit offered under the Matching Payment Act and is tied to a voluntary waiver of the candidate's First Amendment rights, the Commission should not require candidates to remain in the public financing program until they actually receive a payment of funds.

Senator McCain received no matching funds as of February 8, 2008, the date of his request to withdraw and the U.S. Treasury made no subsequent attempts to make payments to him. As a result, Senator McCain was eligible to withdraw from the Matching Payment Program.

(h) Even if Constructive Receipt is Sufficient to Preclude Withdrawal, Respondents Did Not Pledge Public Funds as Security for Private Financing

Even applying a stricter standard, Senator McCain was eligible to withdraw from the Matching Payment Program because the Respondents did not constructively receive public funds by pledging them as private security. In Advisory Opinion 2003-35 (Gephardt for President), the Commission indicated that it would permit a candidate to withdraw from the Matching Payment Program, "provided that the certification of funds has not been pledged as security for private financing." Even if this standard is applied here, Senator McCain was eligible to withdraw

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1 because he and his Committee did not pledge the certification of funds as security for private  
2 financing.

3 Commission regulations that address the use of entitlement to public funds as security for  
4 private loans contemplate an unambiguous pledge of the funds as collateral before the  
5 Commission will recognize that a candidate has pledged public funds as security for private  
6 financing. For example, the shortfall bridge loan exemption, 11 C.F.R. § 9035.1(c)(3), provides  
7 that where a candidate uses the promise of unpaid public funds as "security" for a bridge loan  
8 obtained during a shortfall in the Matching Payment Program account, the interest accrued during  
9 the shortfall period does not count against the candidate's expenditure limit. While not explicitly  
10 defined in the regulations, the very nature of the loan involves a direct pledge of future public  
11 funds as security for a loan to "bridge" a limited period before payment. Similarly, the  
12 Commission's bank loan regulation at 11 C.F.R. § 100.82(c)(2) sets forth circumstances under  
13 which a pledge of future receipts will be deemed to be collateral sufficient to "assure repayment"  
14 of a bank loan, specifically mentioning future payments of public funds as among the type of  
15 future payments that may be pledged. As part of its five-part test for determining whether the  
16 lending institution making the loan has obtained a written agreement in which the candidate or  
17 committee receiving the loan has pledged future receipts, the regulation considers whether the  
18 loan agreement required the public financing payments or other future receipts "pledged as  
19 collateral" to be deposited into a separate depository account for the purposes of retiring the bank  
20 loan debt, and, in the case of public financing payments, whether the borrower authorized the  
21 Secretary of the Treasury to directly deposit the payments into the depository account for the  
22 purpose of retiring the debt. See 11 C.F.R. § 100.82(c)(2)(iv), (v). Based on these regulations,

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1 the Gephardt opinion likely referred to a similarly unambiguous pledge of public funds as  
2 security and a provision to rapidly make those funds available to the creditor when it used the  
3 phrase "pledged public funds as security for private financing."

4 Senator McCain's loan agreements created no such unambiguous pledge of public funds  
5 as security. The original loan agreement provided that "any certifications of matching fund  
6 eligibility, including related rights, currently possessed by Grantor or obtained before January 1,  
7 2008, are not themselves being pledged as security for the indebtedness and are not themselves  
8 collateral." Furthermore, affidavits submitted by the President of McCain 2008, Inc. and the  
9 President and CEO of Fidelity & Trust Bank indicate that the parties made every effort to ensure  
10 that the Loan Agreement and Modification did not pledge public funds as security for private  
11 financing. *See* Response, Exhibit 6, Affidavit of Barry Watkins (Fidelity & Trust Bank); *see also*  
12 Response, Exhibit 9, Affidavit of Richard Davis (McCain 2008, Inc.). The loan agreement did  
13 not provide for public funds rapidly to be made available to the lender for purposes of retiring the  
14 debt. While the Committee granted to the bank as collateral "accounts" and "deposit accounts,"  
15 and the loan agreement gave the bank "a right of setoff in all [of the Committee's] accounts with  
16 [the bank] (whether, checking, savings, or some other account)," there is nothing in the loan  
17 agreement specifically addressing the bank's access to matching funds. Nor did the Committee  
18 give to the Treasury account information at Fidelity and Trust Bank or any other bank into which  
19 to deposit Matching Payment Program funds. Consequently, there is no indication that the setoff  
20 provision would have reached Matching Payment Program funds.

21 Nor did the "in-out-in" provision create a pledge of funds for which Senator McCain was  
22 eligible at the time of the agreement. Even if the "in-out-in" provision induced the bank to make

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1 the loan, merely inducing a creditor to extend credit based on a candidate's eligibility does not  
2 amount to any kind of unambiguous pledge of funds received as a result of that eligibility or give  
3 a creditor any enforceable right against public funds. Moreover, the provision dealt with a  
4 hypothetical second eligibility that may or may not have occurred (and in fact did not occur).  
5 Thus, the "in-out-in" provision pledged no public funds, at least at the time of the agreement,  
6 because at that time no such second eligibility existed. Had the contingencies occurred, and had  
7 Senator McCain then attempted to withdraw from the program a second time, the outcome may  
8 have been different.

9 In light of the detailed language used in the Loan Agreement and Modification to avoid  
10 using the Respondents' certification of eligibility as security for the private loan, it appears that  
11 the Respondents did not constructively receive Matching Payment Act funds. See AO 2003-35  
12 (Gephardt for President). Given the complexity of the Loan Agreement and Modification, and  
13 the context of the Gephardt advisory opinion, Senator McCain also was eligible to withdraw even  
14 under the stricter standard of that advisory opinion.

15 2. Effect of Withdrawal from the Matching Payment Program

16 In past requests by candidates to withdraw from the Matching Payment Program, the  
17 Commission has treated the relationship between a candidate who has been deemed eligible to  
18 receive payments and the Commission as contractual in nature. See LRA 622 (Howard  
19 Dean/Dean for America); see also AO 2003-35 (Gephardt for President). More specifically, the  
20 Commission has explained that both parties to the contract (*i.e.*, the Commission and the  
21 candidate) should be treated as having partially performed in accordance with the terms of the  
22 contract. *Id.* In both the Dean and Gephardt requests to withdraw, the candidates were viewed as

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1 having partially performed by submitting the documentation required by the Matching Payment  
2 Program, while the Commission's partial performance was its examination of the Candidate  
3 Agreements and Certifications and, more significantly, its certification to the Treasury that the  
4 candidates were entitled to initial payments from the Presidential Matching Payment Account.  
5 *See* LRA 622 (Howard Dean/Dean for America) at 2; *see also* AO 2003-35 (Gephardt for  
6 President) at 2-3.

7       Once a candidate and the Commission have entered into and partially executed this  
8 contract, the Commission historically has treated a candidate's request to withdraw from the  
9 program as a request for a rescission of that contract. *See* LRA 622 (Howard Dean/Dean for  
10 America) at 2 fn. 2 & 3; *see also* AO 2003-35 (Gephardt for President) at 2-3. Although neither  
11 the Dean withdrawal memo nor the Gephardt advisory opinion presented the Commission with  
12 the opportunity to directly address the effect of this rescission on the individual candidates or  
13 their respective committees, the Dean withdrawal memo clearly defined rescission by specifically  
14 referencing the definition of the term used in Restatement (Second) of Contracts. *See* LRA 622  
15 (Howard Dean/Dean for America) at 2, fn. 2.

16       Rescission, as used in past withdrawal requests, is "an agreement under which each party  
17 agrees to discharge all of the other party's remaining duties of performance under an existing  
18 contract." Restatement (Second) Contracts, § 283 (1981). A rescission will have the effect of  
19 discharging the parties from their remaining duties, even if "both parties have partly performed  
20 their duties or one or both have a claim for damages for partial breach." *Id.*, Comment a.  
21 Because this discharge of duties frees the parties from any potential claim for damages under  
22 breach, a rescission of a contract has been described as "extinguishing" or "annihilating" the

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1 contract. 17A Am. Jur. 2d § 584. Therefore, "[r]escission voids the contract *ab initio*, meaning  
2 that it is considered null from the beginning and treated as if it does not exist for any purpose."  
3 *Id.*

4 By granting Senator McCain's request to be released from his obligations under the  
5 Matching Payment Program, the Commission has agreed to a rescission of the contract that had  
6 been partially executed between the Commission and the Respondents. As a consequence of this  
7 rescission, both parties have been discharged from their obligations under the contractual  
8 relationship arising from Senator McCain's application to participate in the Matching Payment  
9 Program. More specifically, the Respondents are considered as having never been bound by the  
10 expenditure limits required by 26 U.S.C. § 9035 and 2 U.S.C. § 441a(b)(A)(1).

11 The Commission may further rely on its decision in LRA 561 (Elizabeth Dole for  
12 President) to conclude that the expenditure limitations of 11 C.F.R. § 9035.1(d) do not apply to  
13 candidates who have withdrawn from the Matching Payment Program. In the Dole withdrawal,  
14 neither the candidate nor her committee had received matching funds. At the time that the  
15 candidate requested withdrawal, however, she and her committee sought assurances from the  
16 Commission that she would not be subject to an audit pursuant to 26 U.S.C. § 9038. *See id.*,  
17 Memorandum to the Commission (Dec. 20, 1999) at 1-2. Adopting the General Counsel's  
18 recommendation, the Commission concluded that "if the Candidate is allowed to refuse payment  
19 of matching funds, and in fact receives no matching funds whatsoever, she would not be subject  
20 to audit pursuant to 26 U.S.C. § 9038(a)." *Id.* at 2. This decision emphasized the language of  
21 section 9038(a), which provides, "After each matching payment period, the Commission shall  
22 conduct a thorough examination and audit of the qualified campaign expenses of every candidate

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1 and his authorized committees *who received payments* under section 9037.” Based on this  
2 language, the Commission concluded that, because the candidate had not actually received funds  
3 through the Matching Payment Program, she could withdraw and be treated, for the purposes of  
4 the audit requirement, as if she had never participated in the Matching Payment Program.

5 While 26 U.S.C. § 9035, which imposes spending limitations on participating candidates,  
6 does not contain the term “received” in describing the conditions by which candidates are bound  
7 by the limitations, the Commission’s regulation implementing the statute incorporates language  
8 similar to section 9038. Section 9035.1(d) states, “The expenditure limitations of 11 C.F.R.  
9 [§] 9035.1 shall not apply to a candidate who does not receive matching funds at any time during  
10 the matching payment period.” By including the term “receive” in the regulations implementing  
11 26 U.S.C. § 9035, the Commission indicated that the same standard should be applied when  
12 assessing whether an audit is required or spending limitations are in effect after a candidate has  
13 successfully withdrawn from the Matching Payment Program. Thus, the Commission’s decision  
14 to permit Elizabeth Dole to withdraw without subjecting her campaign to an audit supports the  
15 conclusion that the expenditure limits of 26 U.S.C. § 9035 and 2 U.S.C. § 441a(b)(A)(1) should  
16 not apply to the Respondents since Senator McCain was permitted to withdraw from the  
17 Matching Payment Program.

18 3. Alleged Reporting Violations

19 Political committees that obtain a loan or a line of credit from a lending institution are  
20 required to disclose “the type and value of traditional collateral or other sources of repayment  
21 that secure the loan . . .” on schedule C-1 or C-P-1. 11 C.F.R. § 104.3(d)(1)(iii); *see also*  
22 2 U.S.C. § 434(b). If the receipt of Matching Payment Act funds were pledged by the Committee

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as security in the Loan Agreement and Modification, then the Committee would have been required to disclose the nature of the collateral on schedule C-P-1. However, since the Matching Payment Act funds were not pledged as security for private financing, *see supra*, Part II.B.1.(b), the Committee was not obligated to report funds from the Matching Payment Account as collateral pursuant to 2 U.S.C. § 434(b) and 11 C.F.R. § 104.3(d)(1).

**III. CONCLUSION**

We recommend that the Commission find no reason to believe that John McCain 2008, Inc., Joseph Schmuckler, in his official capacity as treasurer, and John McCain violated 2 U.S.C. § 441a(b)(1)(A) or 26 U.S.C. § 9035 by exceeding the expenditure limitations imposed on candidates receiving federal matching funds.

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8 We further recommend that the Commission find no reason to believe that the Committee  
9 violated 2 U.S.C. § 434(b) and 11 C.F.R. § 104.3(d)(1) by failing to properly report collateral for  
10 Senator McCain's loan on Schedule C-P-1.


11 Finally, we recommend that the Commission approve the "appropriate" Factual and Legal  
12 Analysis that can be discussed at the next Executive Session and have attached a draft Factual  
13 and Legal Analysis to this Report to facilitate that discussion. If necessary, we anticipate  
14 amending the Factual and Legal Analysis at the Commission's instruction to reflect the basis for  
15 any decision.

16 **IV. RECOMMENDATIONS**

- 17 1. Find no reason to believe that John McCain 2008, Inc., Joseph Schmuckler, in his  
18 official capacity as treasurer, and John McCain violated 2 U.S.C. § 441a(b)(1)(A)  
19 or 26 U.S.C. § 9035 because, pursuant to the Commission's decision to grant  
20 withdrawal from the Matching Payment Program and the analysis in Part II.B.1.(a)  
21 of this Report, the expenditure limitations of the Program were not applicable to  
22 John McCain 2008, Inc., Joseph Schmuckler, in his official capacity as treasurer,  
23 and John McCain.  
24

2. Find no reason to believe that John McCain 2008, Inc., Joseph Schmuckler, in his official capacity as treasurer, and John McCain violated 2 U.S.C. § 441a(b)(1)(A) or 26 U.S.C. § 9035 because, pursuant to the Commission's decision to grant withdrawal from the Matching Payment Program and the analysis in Part II.B.1.(b) of this Report, the expenditure limitations of the Program were not applicable to John McCain 2008, Inc., Joseph Schmuckler, in his official capacity as treasurer, and John McCain.
3. Find no reason to believe that the Committee violated 2 U.S.C. § 434(b) and 11 C.F.R. § 104.3(d)(1).
4. Approve the appropriate Factual and Legal Analysis
5. Approve the appropriate letters.
6. Close the file.

November 3, 2008  
Date



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